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# NAVAL POSTGRADUATE SCHOOL
## Monterey, California

# THESIS

REFERENCE GUIDE FOR
FEDERAL GOVERNMENT
ACQUISITION

by

Vincent Thomas O'Connor

September 1983

Thesis Advisor: D. C. Guyer

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Managers and potential managers in the acquisition field should find this thesis to be a useful tool. This thesis, when joined with a thesis written by CDR J. F. Hetherington in March 1983 entitled "A Synopsis of Acquisition Related Topics", will form a single reference that will provide a review of current, important topics relevant to federal acquisition. Individual topics are divided into the

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following categories: contracting and general acquisition; legal; finance, economics and accounting; and production. A broad introduction/definition is given in the initial "discussion" section of each topic for a quick review. Individual topics are generally confined to three to four pages to provide an overview of the topic and mention related concepts. The depth of coverage in each topic should be sufficient for a working knowledge of the concept in relation to negotiation, cost analysis or other aspects of the acquisition field. A list of "references" and a "bibliography for further study" is supplied at the end of most topics as an initial step toward a more in-depth study of the subject matter or for application of the concept to the area of concern.

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# Reference Guide for Federal Government Acquisition

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Submitted in partial fulfillment of the
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MASTER OF SCIENCE IN MANAGEMENT

from the

NAVAL POSTGRADUATE SCHOOL
September 1983

## ABSTRACT

Managers and potential managers in the acquisition field should find this thesis to be a useful tool. This thesis, when joined with a thesis written by CDR J.F. Hetherington in March 1983 entitled "A Synopsis of Acquisition Related Topics", will form a single reference that will provide a review of current, important topics relevant to federal acquisition. Individual topics are divided into the following categories: contracting and general acquisition; legal; finance, economics and accounting; and production. A broad introduction/definition is given in the initial "discussion" section of each topic for a quick review. Individual topics are generally confined to three to four pages to provide an overview of the topic and mention related concepts. The depth of coverage in each topic should be sufficient for a working knowledge of the concept in relation to negotiation, cost analysis or other aspects of the acquisition field. A list of "references" and a "bibliography for further study" is supplied at the end of most topics as an initial step toward a more in-depth study of the subject matter or for application of the concept to the area of concern.

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# I. INTRODUCTION

Purchase requests, which must be controlled through a sometimes long and complex acquisition process, currently deluge Federal Government Acquisition Organizations. The Federal Government purchases property and services from the private sector in excess of $150 billion annually. The sheer volume of more than 18 million purchase actions required each year for this expenditure is indicative of the enormous scope of the procedures involved. Two statutes provide guidance for the Federal Government to contract and to issue regulations for contracting. The Armed Services Procurement Act of 1947 pertains to Department of Defense activities, the National Aeronautics and Space Administration, and the Coast Guard. However, each has its own implementing regulations. Titles II and III of the Federal Property and Administrative Services Act of 1949, as amended (The Federal Property Act), pertain to purchase activities of Civil Agencies. Acquisition for the Federal Government can become a complex affair because, in addition to the two basic procurement statutes, there are many statutory requirements and Executive Orders that foster social and economic aims other than acquisition. To stay current in this dynamic environment, the acquisition manager needs a single reference to acquisition containing the impact of Federal, DOD and other directives.

A thesis that initiated development of a single reference which provides a overview of current, important topics relevant to federal acquisition was written by CDR J.F.

Hetherington in March 1983 entitled "A Synopsis of Acquisition Related Topics". The purpose of this thesis is to complement CDR Hetherington's thesis by developing additional topic areas in the acquisition field and, when joined with his thesis, form a single reference. This thesis is not to be used alone, but as a guide to the pertinent documents, directives, circulars, etc. To retain its value as a "current" guide, this thesis should be updated and supplemented on at least an annual cycle.

Following the guidelines set by CDR Hetherington format and restrictions will be as follows:

A. The term "acquisition" shall be used in this thesis in place of the term "procurement". Procurement is to be considered synonymous with "contracting" as a subset of the acquisition functions. "Acquisition", as defined by the Office of Federal Procurement Policy, means the acquiring by contract with appropriated funds of property or services by and for the use of the federal government through purchase, lease, or barter, whether the property or services are already in existence or must be created, developed, demonstrated, and evaluated. Acquisition includes such related functions as determination of the particular public need, solicitation, selection of sources, award of contracts, contract financing, contract performance, and contract administration.

B. The selected topics are grouped into the following chapter headings:

Contracting and other General Acquisition Subjects,

Legal,

Finance, Economics and Accounting, and

Production.

C. An attempt will be made to condense all topics to a maximum of four pages, not including tables, lists, graphs or charts. This will allow the user of this thesis to be able to scan each topic area and develop a working knowledge in the area of interest. The user will also be able to use the references and bibliography available at the end of most topics to conduct an in depth study of the area, if required.

Later updates or supplements of topics, references and prepared synopsized topics should be forwarded to the Acquisition and Contracting Management Academic Associate, Department of Administrative Sciences, Naval Postgraduate School, Monterey, California 93940.

## II. CONTRACTING AND GENERAL SUBJECTS

### A. PERFORMANCE OF COMMERCIAL ACTIVITIES (OMB CIRCULAR NO. A-76)

#### 1. Discussion

In 1966 the first Circular No. A-76 was issued by the Bureau of the Budget. This Circular affirmed "the Government's general policy of relying on the private enterprise system to supply its needs" but it also recognized some instances where "it is in the national interest for the Government to provide directly the products and services it uses." [Ref. 1]

The basic policy underwent a major change with the issuance of Office of Management and Budget (OMB) Circular A-76 (revised) dated 29 March 1979. Unlike the previous statement which only stressed government reliance on private enterprise, the new policy has three guiding principles [Ref. 2]:

a. Rely on the private sector. The Government's business is not to be in business. Available private sources should be first considered to provide the commercial or industrial goods and services needed by the Government to act on the public's behalf.

b. Retain certain governmental functions in-house. Certain functions are inherently governmental in nature, being so intimately related to the public interest as to mandate performance by Federal employees.

c. Aim for economy and cost comparisons. When private performance is feasible and no overriding factors require in-house performance, the American people deserve and expect the most economical performance and, therefore, rigorous comparison of contract costs versus in-house costs should be used to decide how the work will be done.

2. Present Procedures

If a service activity is not specifically excluded from OMB A-76 and is not an inherently governmental function, then it is classified as a Commercial Activity. A commercial or industrial activity is defined by A-76 as "one which is operated and managed by a federal executive agency and which provides a product or service that could be obtained from a private source." Attachment A to OMB A-76 provides approximately one hundred examples of Commercial Activities for fifteen different service categories.

In-house performance of Commercial Activities cannot be justified solely on the basis that an activity supports or involves a classified program, or is part of an agency's basic mission, or that there is a possibility of a strike by contract employees. Government operation of a Commercial Activity can only be authorized under one of the following conditions [Ref. 2]:

a. No satisfactory commercial source is available. Government operation is permitted whenever it can be documented that either:

(1) There is no private commericial source capable of providing the needed service; or

(2) That the use of a private source would cause

unacceptable delay or disruption of an essential program. The required documentation must be detailed in terms of cost, time, and performance measures. The disruption must be of a lasting nature and not just temporary.

b. National Defense.

(1) Government operation by military personnel is permitted whenever:

(a) The personnel are utilized in or subject to deployment in a direct combat or combat service support role;

(b) The activity is essential for military training; or

(c) The activity is required to provide appropriate work assignments for career progression or a rotation base for overseas or sea to shore assignments.

(2) Government operation of a depot or intermediate level maintenance facility may be justified to ensure a ready and controlled source of technical competence and resources necessary to meet military contingencies.

c. Lower cost. If none of the preceding conditions can be met, government operation of a Commercial Activity can only be authorized when a comparative cost analysis, performed in accordance with A-76 and the Cost Comparison Handbook, shows that in-house operation has a lower total cost than if it were obtained from a qualified private source.

Currently an estimated 400,000 federal government employees perform Commercial Activities valued at $20 billion annually. Of this amount, only $6 billion are eligible for cost studies; the other $14 billion are exempt from A-76 for reasons of national defense. Although progress is accelerating rapidly, to date only a small portion of the eligible functions have received a cost comparison. The Office of Federal Procurement Policy (OFPP) estimates that a savings of over $5 billion could be achieved over the next five years if these cost studies were completed [Ref. 3].

Since 1979, DOD has saved approximately $140 million per year as a result of Commercial Activity studies. In addition, an average of 4,000 personnel billets have been converted to contract in each of the last four years [Ref. 3]. Data compiled in January 1982, showed that 60 percent of the functions reviewed shifted to contract and the average costs dropped 19 percent. These reductions were widely distributed however, with two-fifths showing greater than 30 percent savings, another two-fifths having savings between 11 and 25 percent, and the remainder saving 10 percent or less [Ref. 4].

3. Proposed Revisions to Circular A-76

The Office of Federal Procurement Policy's proposed changes to the Circular and Handbook, dated January 6, 1983, are designed to simplify the cost comparison procedure. The Circular itself would be changed only slightly, but the revisions would add a new supplement. The Supplement is written in four parts; Policy Implementation, Management Study Guide, Writing and Administering Performance Work Statements, and Cost Comparison Handbook [Ref. 5]. The significant changes contained in the circular are:

a. Agencies do not have to conduct a cost comparison

study for activities that have 10 or fewer Full Time Equivalent Work Years (FTE). An FTE is equivalent to 2,080 annual hours of work.

b. If an activity has over 10 FTE's an agency may waive cost comparisons if there is effective price competition and there is compelling evidence that the in-house bid would not win. This evidence could come from GAO reports previous cost studies, or other price experience.

c. Consolidation of Commercial Activities (CA) is encouraged but special requirements must be followed for small and small disadvantaged business to foster their business opportunities. For example, primes will be required to submit small and small disadvantaged subcontracting plans and a minimum of 50 percent subcontracting shall be formally advertised procurements.

d. Agencies may award contracts in accordance with socio-economic programs such as 8(a) contractors, and Federal prisons without conducting a cost comparison. A-76 is not intended to interfere with agencies' socio-economic procurement goals; therefore, cost studies are optional.

e. The appeals procedure has been strengthed to include a description of documentation that must be made available to appellants and what can be appealed. Also, the agency head now has the authority to review appeals.

f. An annual reporting requirement has been added which requires agencies to report to OMB on their progress in implementing the Circular. This

revision requires all activities to be reviewed for commercial performance by September 30, 1984.

g. A management study guide has been added to aid the agencies in developing their most efficient organization from which to develop the Government cost.

h. The accounting methodology has moved from one of calculating all costs of each alternative (i.e., in-house vs. contract) to identifying all costs but calculating only the cost that would change if the decision were to change the status quo. For example, calculating the in-house Government costs that would be avoided in the event of contracting out.

i. Contract administration costs will now be based on the estimated costs to administer each contract. A ceiling is placed on the staffing allowed for contract administration.

j. Illustrations with full explanation of how to develop Government costs have been added to further simplify the requirements. This is especially significant in the area of personnel costs.

4. References

1. Bureau of the Budget Circular No. A-76, Subject: Policies for Acquiring Commercial or Industrial Products and Services for Government Use, 3 March 1966

2. Office of Management and Budget Circular No. A-76 (Revised), Subject: Policies for Acquiring Commercial or Industrial Products and Services Needed by the Government, 29 March 1979.

3. "DOD Revising Policy on Consolidating Commercial

Activities," Federal Contracts Report 39 (21 March 1983) : 657-659 .

4. Congressional Budget Office, Contracting Out for Federal Support Services: Potential Savings and Budgetary Impacts, October 1982.

5. "Current Issues Under OMB Circular A-76," Federal Contracts Report 39 (20 June 1983) : 1186-1193.

## B. MAJOR SYSTEM ACQUISITIONS (OMB CIRCULAR NO. A-109)

### 1. Discussion

Circular A-109 was developed in response to recommendations made by the Congressionally constituted Commission on Government Procurement (COGP) in November 1969. The COGP was created to study and recommend to Congress methods that would promote the economy, efficiency and effectiveness of Federal procurement by the Executive Branch [Ref. 1]. In studying system acquisitions, the COGP was concerned about cost overruns, scheduling failures and systems that failed to meet expectations. The root cause of these problems centered on the absence of visibility of key decisions; confused and overlapping roles among industry, in-house designers, congressional committees, and executive branch administrators; and lack of a logical, clear decision framework to guide the acquisition process and its participants [Ref. 2]. The COGP made 149 recommendations. Of these, twelve recommendations involved improvements to major system acquisition [Ref. 3].

As a result of one of the recommendations of the COGP, the Office of Federal Procurement Policy (OFPP) was established within the Office of Management and Budget (OMB). OFPP is charged with establishing procurement policies across all executive branch agencies of the Federal Government. One of the first outputs of OFPP was Circular A-109, issued in April 1976, culminating a nearly two-year joint Administration and Congressional effort to establish policy guidelines applicable to all Federal Agencies engaged in developing major systems.

2. Policy

OMB Circular A-109 is consistent with the intent of the twelve recommendations of the COGP. It is a landmark document which adds several new dimensions to the business of defining and funding major systems in the fulfillment of basic agency roles and missions. Circular A-109 provides guidance to all executive agencies for the establishment of a common framework for acquisition policy formulation and program implementation.

A principal intent of the reforms embodied in Circular A-109 is to enhance competition and reorient major systems acquisition to focus on the earlier phases of the process, not just on full-scale development. It is intended that competition in early phases will be broader based, require less commitment of resources, and provide the best solutions to national needs primarily through innovation. Circular A-109 requires agencies to:

a. Express needs and program objectives in mission terms and not equipment terms to encourage innovation and competition in creating, exploring, and developing alternative systems.

b. Place emphasis on the initial phase of the system acquisition process to allow competitive exploration of alternative systems to meet mission needs.

c. Communicate with Congress early in the system acquisition process by relating major system acquisition programs to agency mission needs.

d. Establish clear lines of authority, responsibility, and accountability for management of major systems, make decisions at appropriate managerial levels,

and obtain agency head approval at key decision points in the evolution of each acquisition program.

e. Designate a focal point to integrate and unify the system acquisition management process and monitor policy implementation.

f. Rely on private industry in accordance with the policy established by OMB Circular A-76.

3. Implementation

Circular A-109 emphasizes Congressional and Executive leadership at the front end of the systems acquisition cycle. It states that while "technical and program decisions normally will be made at the agency-component or operating-activity level," four key decisions "should be made by the agency head." These four decision are [Ref. 4]:

a. Identification and definition of a specific mission need to be fulfilled, the relative priority assigned within the agency, and the general magnitude of funds invested;

b. Selection of competitive system design concepts to be advanced to a test/demostration phase or authorization to proceed with the development of a noncompetitive (single concept) system;

c. Commitment of a system to full-scale development and limited production;

d. Commitment of a system to full production.

Significant benefits anticipated from implementation of Circular A-109 included:

a. Greatly reduced cost overruns and elimination of much of the controversy of the past two decades regarding the need for specific systems.

b. Improved opportunities for innovative private sector contributions to meet national needs.

c. Information flow between agencies and Congress consistent with the Congressional Budget Act of 1974.

d. An orderly process for acquiring major systems in all agencies, thus eliminating inconsistencies of management attention and approach while providing flexibility for agencies to meet unique needs.

By implementing these policies, billions of dollars could be saved by avoiding program start-ups that are later cancelled when it is realized that the need did not exist, other programs were given a higher priority, or the program was satisfied by other less costly means.

4. OFPP Pamphlet No. 1

To further amplify the intent of Circular A-109 and to establish key decision points through a Major Systems Acquisition Cycle, OFPP issued OFPP Pamphlet No. 1 in August 1976. In this pamphlet the Major System Acquisition Cycle is seen as a single closed loop with four key decision points. The cycle consists of the following activities with the four decision points following activities b, c, d, and e:

a. Mission analysis;

b. Evaluation and reconcilation of needs in the context of agency mission, resources and priorities;

c. Exploration of alternative systems;

d. Competitive demonstrations;

e. Full scale development, test, and evaluation;

f. Production; and

g. Deployment and operation.

The four decision points are the specified points at which the agency head must make an approval before proceeding with subsequent phases of the acquisition.

5. References


1. Commission on Government Procurement, Report of the Commission on Government Procurement, Summary, Government Printing Office, Washington, D.C., 1972.

2. Comptroller General of the United States' letter to The Director, Office of Management and Budget, dated 3 March 1981.

3. Commission on Government Procurement, Report of the Commission on Government Procurement, vol. 2, Part C, Acquisition of Major Systems, Government Printing Office, Washington, D. C., 1972.

4. Office of Management and Budget Circular A-109, Subject: "Major Syustems Acquisition," Executive Office of the President, 5 April 1976.

## 6. Bibliography for Further Study

Office of Management and Budget, Office of Federal Procurement Policy Pamphlet No. 1, Subject: "Major Systems Acquisition, A discussion of the Applications of OMB Circular A-109," August 1976.

## C. CENTRALIZATION OF THE PURCHASING FUNCTION

### 1. Discussion

The terms centralization and decentralization are frequently used in management and purchasing literature to describe the level at which purchasing decisions are made. Centralization of purchasing refers to an organization where purchasing for the entire organization occurs at, or is controlled by, one central purchasing office. Decentralization of purchasing refers to separate purchasing offices for each operating division or major operational location each with a considerable degree of autonomy in buying. Two examples will illustrate the differences. Centralization takes place when an individual or department is established and given authority to make all purchases [Ref. 1]. This individual or the department is held accountable by management for the operation of the company's purchasing activities.

Decentralization of purchasing occurs when personnel from other functional areas of the organization -- production, engineering, sales, finance, etc.-- decide on sources of supply, negotiate with vendors directly, or perform many other functions of purchasing [Ref. 2]. Generally speaking, the advantages of one approach are the disadvantages of the other, thus organizations, including the Federal Government, that have different levels of operation could adapt one of the following alternatives:

a. Complete Centralization.
b. Complete Decentralization.
c. A combination of Centralization and Decentralization.

2. Complete Centralization

Complete centralization of purchasing emphasizes the need for one set of standards within an organization. A single centrally controlled purchasing policy, combined with greater quantity purchases, result in outright purchasing power. Lee and Dobler [Ref. 2] state that when functioning properly, centralized purchasing produces several benefits. They are summarized as follows:

a. Unity of Organization

(1) Duplication of effort and haphazard purchasing practices are minimized by the central coordination of all company purchases.

(2) Responsibility for the performance of the purchasing functions is fixed with a single department head, thereby facilitating management control.

(3) More effective inventory control is possible because of companywide knowledge of stock levels, material usage, lead times, and prices.

b. Efficiency

(1) Quantity discounts are made possible by consolidating all company orders for the same and similar materials.

(2) Centralization develops purchasing specialists whose primary concern is purchasing. These specialists buy more efficiently than less skilled persons who view purchasing as a secondary responsibility.

(3) Line department managers do not have to spend

their time purchasing. They can devote full time and effort to their basic responsibilities.

(4) Record keeping is reduced and at the same time made significantly more effective.

(5) Fewer orders are processed for the same quantity of goods purchased, thus reducing purchasing, receiving, inspection, and accounts payable expense, as well as prices.

c. Economies of Scale

(1) A firm is able to develop and implement a unified procurement policy, enabling it to speak with a single voice to its vendors. Maximum competitive advantage can than be taken from its total economic power.

(2) Transportation savings are realized by the consolidation of orders and delivery schedules.

(3) Suppliers are able to offer better prices and better service because their expenses are reduced.

3. Complete Decentralization

In large departments, which are found in many moderate sized organizations and are universal among the larger companies, the question arises as to whether to do all purchasing from a centralized department or to set up separate purchasing offices in each department. This type of purchasing office would have a considerable degree of autonomy in buying and is referred to as decentralization of purchasing. The reasons for decentralization may be summarized as follows:

a. The manager of a functional area has the authority and responsibility to run his department in the most efficient and effective manner possible. Since materials could represent a large proportion of an effective operation, the manager should have control over purchases in order to maintain continuity in producing the required item (whether it be a production area, maintainance area, or service area).

b. The manager would be able to respond to emergency requirements partially because of the direct line of communication with the vendor and partially because of the awareness of the source and availability of the item required.

c. When the distance to a central purchasing area is significant, a potentially serious time lag may result. Decentralizing, by setting up a purchasing office in the building/plant involved, would eliminate duplication of paperwork and records. This would give each department that requires the material a vehicle for direct, daily contact that is often sacrificed with centralization.

4. A Combination of Centralization and Decentralization

According to Heinritz and Farrell [Ref. 3] the most widely used arrangement is a compromise designed to obtain the advantages of both methods of organization. Some of their specific means of developing and maintaining such a system include:

a. The establishment of uniform policies, forms, and procedures at all plants through a company-wide purchasing manual with uniform quality standards established by company-wide specifications.

b. A continuing review of all purchasing activities by obtaining copies of purchase orders routed to the central office. Also a requirement for systematic monthly reports from all branch purchasing departments correlated at the central office and redistributed to the branches in a summary report form, containing buying recommendations, will be maintained.

c. By establishing dollar value limitation on branch plant purchases, orders or contracts in excess of the stated limit would be subject to approval by the central department. This corresponds to the regulation in many purchasing departments that orders amounting to more than a stated dollar value must be approved by the head of the department or by some higher executive.

d. Certain items, usually major materials in common use at two or more plants, are designated as contract items and are purchased by the central department for all plants. In some cases, the initial requirement of a new item is purchased by the plant purchasing department, with subsequent review to determine whether or not it shall be classified as a contract item. A variation of this is to delegate the purchase of specified items to a designated plant purchasing department in which the item is used in greatest volume.

e. Contracts for items in common use are made by the central department, with provision for shipment to all company locations.

## 5. References


1. Leenders, Michiel R., Fearon, Harold E. and England, Wilbur B., *Purchasing and Materials Management*. Richard D. Irwin, Inc., 1980.

2. Lee, Lamar, Jr. and Dobler, Donald W., *Purchasing and Materials Management: Text and Cases*. Mc Graw-Hill Book Company, 1977.

3. Heinritz, Stuart F. and Farrell, Paul V., C.P.M., *Purchasing: Principles and Applications*. Prentice-Hall, Inc., 1981.

## D. STANDARDS OF ETHICAL CONDUCT

### 1. Discussion

Executive Order (EO) 11222, 8 May 1965, as amended by EO 12107, 28 December 1978, prescribes standards of ethical conduct for Government officials and employees, and sets forth the basic policy which underlies these standards:

> Where Government is based on the consent of the governed, every citizen is entitled to have complete confidence in the integrity of his Government. Each individual officer, employee, or advisor of Government must help to earn and must know that trust by his own integrity and conduct in all official actions.

All Federal employees are morally obligated to guard against acts that give the appearance or that might even presume to be in conflict between their personal interest and the interest of the Government. Public trust must be retained toward the Government and in the integrity of the people who make it function. An awareness of the regulations governing ethics and the standards of conduct is critical to an effective program of ensuring the highest standards of conduct by Federal employees.

### 2. Regulations

Many laws and regulations apply to ethics and standards of conduct for Federal Government employees. Among these are:

a. United States Code. Most of the statutory guidelines appear in Titles 5, 10, 18, and 41. These standards apply to all government personnel except where specifically limited to certain people. The sections that deal with Conflict of Interest Laws are:

(1) 18 U.S.C. 203. Subsection (a) prohibitions are encompassed by prohibitions in 18 U.S.C. 205. Subsection (b) makes it unlawful to offer or pay compensation, the solicitation or receipt of which is barred by subsection (a).

(2) 18 U.S.C. 205. This section prohibits Government personnel from acting as agent or attorney for anyone else before a department, agency, or court in connection with any particular matter in which the United States is a party or has a direct and substantial interest. There are certain exemptions that are described in this section that should be referred to when dealing in this area.

(3) 18 U.S.C. 208. Subsection (a) requires executive branch personnel to refrain from participating as Government personnel in any matter in which they, their spouses, minor children, or partners have financial interest or in which businesses or nonprofit organizations with which such personnel are connected or are seeking employment have financial interests. Subsection (b) permits agencies to grant an ad hoc exemption from subsection (a) if the outside financial interest is deemed not substantial enough to affect the integrity of Government services.

(4) 18 U.S.C. 209. This section describes the policy preventing (and exemptions to) executive branch personnel from receiving any salary or supplementation of salary from a private source as compensation for their Government service.

(5) 18 U.S.C. 207. This section is applicable to former DOD personnel permanently prohibiting them from acting as agent or attorney for anyone other than the United States in connection with matters involving a specific party in which (a) the United States has a direct and substantial interest, and (b) the former personnel participated personally and substantially while holding a DOD position. These personnel having had only related official responsibilites are prevented from above participation for one year.

(6) 18 U.S.C. 281. Prohibits a retired regular Officer of the Armed Forces, at all times, from representing any person in the sale of anything to the Government through the Military Department in whose service he holds a retired status.

(7) 18 U.S.C. 283. Prohibits a retired regular officer of the Armed Forces, within 2 years of his retirement, to act as agent or attorney for prosecuting any claim against the Government. Further, he may not at any time help in the process of a claim if such claim involves any subject matter with which he was directly connected while on active duty.

b. Executive Order 11222 was signed on 8 May 1965 by President Johnson and prescribes the standards of ethical conduct within the Executive Branch and which provides the basic ground rules for Federal employees. The executive order lists six general prohibitions:

(1) Using public office for private gain.

(2) Giving preferential treatment to any person or entity.

(3) Impeding government efficiency or economy.

(4) Losing complete independence or impartiality.

(5) Making a government decision outside official channels.

(6) Acting in any way which adversely affects the confidence of the public in the integrity of the government.

Each of these prohibitions is preceded by the admonition that personnel shall avoid any action which might result in or might reasonably be expected to create the appearance of the existence of the specified proscription.

c. Defense Acquisition Regulations

(1) 1-111 (Reports of Suspected Criminal Conduct, Noncompetitive Practices, Kickbacks, and Other Procurement Irregularities). This section discusses reporting procedures for noncompetitive practices, subcontractor kickbacks, and Contractor Gratuities to Government Personnel.

(2) 1-113 (Standards of Conduct). This section discusses standards of conduct for government personnel and organizational conflicts of interest. It also references the following implementing instructions for Department of Defense Activities: AR600-50, for the Army; SECNAV Instr. 5370.2 for the Navy; AFR30-30, for the Air Force; DLAR 5501.1, for the Defense Logistics Agency; DCA Inst. 220-50-1, for the Defense Communications Agency; DNA

Inst. 5500.7A, for the Defense Nuclear Agency; and DMA Inst. 5500.1, for the Defense Mapping Agency.

(3) 1-115 (Noncollusive Bids and Proposals). This section states clauses and other requirements to promote full and free competition for Government contracts.

(4) 1-500 (Contingent or Other Fees). This section sets forth the procedures to be followed and prescribes the form to be used for obtaining information concerning contingent or other fees paid by contractors for soliciting or securing contracts from the Department of Defense.

(5) 1-600 (Debarment, Ineligibility, and Suspension). This part prescribes policies and procedures relating to the debarment and suspension of bidders, offerors, contractors, subcontractors, and other firms and individuals.

3. Summary

Ethical conduct commensurate with (or, often, superior to) the moral and cultural climate in which we live has always been a basic tenet of military conduct. The amount of attention devoted to the topic has, however, varied. As the pendulum of public interest in violations of the standards swings from neglect to over-reaction and back again, so does the action taken in the military to ensure compliance with the standards [Ref. 1]. There is no segment of the Federal Government that goes unnoticed from this focusing of attention. Whether civilian employee or active

duty military, everyone must be familiar with and adhere to the above guidelines.

4. References

1. Lawrence, K. D., Captain, JAGC, USN and Coyle, R. E., ICDR, JAGC, USN, "Standards of Conduct in the Navy: A Primer" The JAG Journal, March, 1979.

## E. GOVERNMENT FURNISHED PROPERTY

### 1. Government Furnished Property Policy

The general policy of the Department of Defense (DOD) is that contractors use privately owned property in the performance of contracts. However, there are many reasons the Government will furnish property to a contractor. The most common is to facilitate effective and economic procurement. Other reasons include:

a. To assist the contractor in performance of the contract.
b. To ensure proper security.
c. To encourage standardization of property.
d. To further broaden the industrial base for an item throughout the country.
e. To increase competition in cases where it attracts more bidders by providing equipment and material which would not be generally available.
f. To be used as a method for improving manufacturing processes.

### 2. Definition of Property Types

It is important for management purposes to classify property into separate categories since there are different policies associated with each category of property. Different requirements for records-keeping, physical control and reporting are but a few of the differences. The Defense Acquisition Regulation (DAR) states that Government property means all property owned by or leased to the Government or acquired by the Government under the terms of a contract. Government property provided to a contractor includes both Government Furnished Property (GFP) and Government Acquired Property. This property is classified by DAR into:

a. Facilities (DAR 13-101.8). Facilities means industrial property for production, maintenance, research, development, or test, including real property and rights therein, buildings, structures, improvements and plant equipment.

b. Special tooling (DAR 13-101.5). This type of property is defined as all jigs, dies, fixtures, molds, patterns, taps, gauges, other equipment and manufacturing aids, and replacements thereof, which are of such a specialized nature that, without substantial modification or alteration, their use is limited to the development or production of particular supplies or parts thereof, or the performance of particular services.

c. Special test equipment (DAR 13-101.6). Special test equipment means either single or multipurpose integrated test units engineered, designed, fabricated, or modified to accomplish special purpose testing in the performance of the contract.

d. Material (DAR 13-101.4). Material means property which may be incorporated into or attached to an end item to be delivered under a contract, or which may be consumed in the performance of a contract.

e. Military property (DAR 13-101.7). Military property means personal property designed for military operations. It includes end items and integral components of military weapons systems, along with related peculiar support equipment which is not readily available as a commercial item.

### 3. Problems with Government Furnished Property

A major problem attributed to GFP is that the Government, when providing GFP, must assume responsibility for on-time delivery, functional performance, quality, reliability, maintainability and part of the technical interface of the GFP with the system being acquired.

Other common problems associated with GFP are those that relate to late or defective GFP. When late, the contractor may be forced to slip his production schedule, which, in turn, may have an adverse effect on the contract delivery date, increase the cost, and create possible claims by the contractor for delay and disruption. Similarly, many reasons for defective material can occur, such as: improper quality control during production, faulty testing, damaged during shipment, improper handling and improper installation. If GFP is found to be defective, it is the Government's responsibility to replace or repair the item. As with late deliver of GFP, defective GFP can increase the costs, jeopardize the delivery schedule and subject the Government to delay and disruption claims.

Another problem associated with GFP is that the total value of DOD Government property at contractors' plants is estimated to be $33 billion and DOD does not know precisely how much Government property contractors actually do possess. No overall management or financial system exists to account for these items [Ref. 1]. The current DOD procedure relies, for the most part, on contractors' records for accounting purposes. No records are kept by DOD in any given central location.

In a House Subcommittee hearing held in October of 1981, evidence was presented that claimed that DOD property administrators did not enforce existing regulations and that the contractor's property records were unreliable. The

subcommittee's report spoke mainly to Government Furnished Material (GFM), but the following recommendation made by the House panel can be considered appropriate in the handling of all government property: (1) place the responsibility for coordinating all actions planned and underway for improving management and accountability for GFM in one adequately staffed central office; (2) have DOD property administrators enforce the contracts in accordance with the Defense Acquisition Regulation and periodically check the GFM for losses and excesses; (3) develop a plan of action as soon as possible to install accounting controls over GFM within DOD and get the applicable systems approved by GAO; (4) involve as many contractors as feasible to test the practicality of selling material to contractors instead of providing GFM; (5) review the various GAO and DOD audit reports relating to GFM and implement the recommendations, particularly concerning the systematic review of its major GFM contracts to identify any excess material and validate the findings; (6) increase the number of property administrators assigned to contractors' plants; and (7) control production contractors' access to DOD's supply system.

4. Contract Clauses

There is no substitute for a thorough familiarity with the various contract provisions relating to Government property. Most of the requirements for property management are contained in the following DAR/FAR clauses:

a. Clauses for Fixed-Price Supply Contracts

| | | |
|---|---|---|
| Required: | DAR 7-103.6 | Title and Risk of Loss |
| | FAR 52.245-2 (c) (g) | |
| When Applicable: | | |
| | DAR 7-104.24 | Government Property |
| | FAR 52.245-2 | |

DAR 7-104.25 Special Tooling
FAR 52.245-18
DAR 7-104.26 Special Test Equipment
FAR 52.245-19

b. DAR/FAR Clauses for Cost-Reimbursement Type Supply Contracts:

Required: DAR 7-203.21 Government Property
FAR 52.245-4

When Applicable:
DAR 7-204.38 Special Test Equipment
FAR 52.245-19
DAR 7-205.3 Title and Risk of Loss
FAR 52.245-4 (c) (g)

5. References

1. "Defense Management: Inadequate Pentagon Controls over Government-Furnished Material Criticized by House Committee," Government Contract Services, Number 2-82, 31 January 1982.

6. Bibliography for Further Study

U.S., Congress, Subcommittee of the Committee on Government Operations, Inadequate Control over Government Material Furnished to DOD Contractors. 97th Cong., 1st sess., 1 October 1981.

# III. LEGAL SUBJECTS

## A. PROTEST AGAINST AWARDS

### 1. Discussion

A contractor bidding on a government contract has unique legal and administrative rights with respect to the proposal, evaluation and selection process. Contractors responding to a request for bids or proposals do so hoping to realize a profit or other advantage. Often a contractor will expend a large amount of money to properly prepare his bid or proposal. He expects that his offer will be fairly considered and that he will receive a contract if his bid or proposal is the most advantageous to the Government. A contractor dealing with a commercial company has only the presumption that the company will act in its own best interest by selecting the most advantageous offer. Unsuccessful contractors responding to a Government solicitation are provided a variety of forums to administratively and/or judicially challenge actions of procurement officials that resulted in the selection of the successful contractor. These forums are the Government contracting agency, the Comptroller General, and the courts. [Ref. 1]

### 2. Protest to the Government Contracting Agency

There is no requirement that contractors first file a protest with a contracting agency before filing with the Comptroller General or the courts. However, this is the first forum in which a protest may be lodged and it is

sometimes the most expedient. Contracting Officers must consider all protest or objections to the award of a contract whether made before or after the award. If the protest is oral and the Contracting Officer is unable to resolve the matter, written confirmation of the protest must be asked for. The protestor must than be notified in writing of the final decision on the written protest [Ref. 2].

3. Protest to the Comptroller General

The General Accounting Office (GAO), provides unsuccessful bidders an alternative means of appealing actions taken by the contracting agency in awarding Government contracts. Since 1925 GAO has entertained bid protests which allege violation of the statutory and regulatory provisions which govern the formation of Government contracts. GAO has the authority to settle all accounts in which the U.S. is concerned. The number of protests filed with GAC has gradually increased over the years, and since the early 1970's has grown from an average of more than 1,000 per year to over 2,000 in 1982 [Ref. 3].

GAO will consider a bid protest based on virtually any allegation of impropriety during the solicitation and award process. Common protests include: (a) an irregularity occurred in the bidding process, (b) the Government evaluated the bids other than it said it would, (c) the Government erred in computing bids, and (d) the Government acted arbitrarily or contrary to its own regulations [Ref. 1].

GAO considers protest pursuant to its Bid Protest Procedures (4 C.F.R. part 20). Two noteworthy provisions of the procedures are:

a. Interested Party. A protest may be filed by any

party that is considered "interested". Whether a party is sufficiently interested to have its protest considered by GAO depends on the facts and circumstances of the particular case [Ref. 4]. GAO has recently decided that a protestor's failure to submit a bid in response to an allegedly defective solicitation does not bar its status as an "Interested Party" [Ref. 5]. Under this interpretation a protestor need not necessarily submit a bid in order to be an "Interested Party" if it files a timely protest and, if successful, would have an opportunity to submit a bid on a possible resolicitation.

b. Timeliness. Protests based upon apparent improprieties in solicitations must be filed prior to bid opening or the closing date for receipt of proposals (4 C.F.R. 20.2 (b)). Protests on all other grounds must be filed within 10 working days after the protester knows or should know its basis for protest, whichever is earlier (4 C.F.R. 20.2(b)(2). If a protest is filed initially with the contracting agency, any subsequent protest to GAO must be filed within 10 working days after the protestor is is notified or should know of "initial adverse agency action" (4C.F.R. 20.2(a)).

While the number of protest to GAO have increased over the years, the procedures involved have inherent weaknesses. The GAO has no authority to enjoin contract award pending its resolution of the protest, nor does it have any authority to interfere with the performance of a contract already awarded. Thus, a protest may be sustained without any practical remedy to the protester because of the advanced state of performance achieved while the protest was being decided [Ref. 6].

4. Protests to Courts

If a protestor does not receive a satisfactory result from the procedures described above, or in lieu of those procedures, the protestor may take his complaint to the U.S. Claims Court for pre-award protest or a Federal District Court for post award protest.

On April 2, 1982, President Reagan signed into law the Federal Courts Improvement Act of 1982 (FCIA). Recognizing the limitations of the GAO and the reluctance of the federal courts nationally to interfere with a process about which they know little or nothing, Congress, in the FCIA, attempts to combine the advantages of a forum having both specialized knowledge and the enforcement powers of a federal court. The result was the creation of the U.S. Claims Court with its new "exclusive" jurisdiction over contract claims "brought before the contract is awarded" [Ref. 6]. Section 133(a)(3) of the FCIA provides in full:

> To afford complete relief on any contract claim brought before the contract is awarded, the court shall have exclusive jurisdiction to grant declaratory judgments and such equitable and extraordinary relief as it deems proper, including but not limited to injunctive relief. In exercising this jurisdiction, the court shall give due regard to the interests of national defense and national security.

Although the U.S. Claims Court was established for pre-award protest and the federal district courts still hear post award protest, questions of proper interpretation of jurisdiction have recently occurred. A federal circuit court, in a recent case, ruled that disappointed bidders may seek relief in the Claims Court only if a complaint is filed before award of the contract sought [Ref. 6]. Once award is made by the agency, bidders must seek relief in federal district court. In this case the protest was originally made to the contracting agency and the contracting officer

stated in writing that he would advise the disappointed contractor of the decision on the protest before the award was made.

5. Summary

When a protest is filed prior to an award of a contract to either the contracting agency or to GAO, notice of this protest should be given to all bidders affected by it. When a written protest against the making of an award is received, the award is not made until the matter is resolved or unless the contracting officer determines that:

a. The items to be purchased are urgently required;

b. Delivery or performance will be unduly delayed by a failure to make award promptly; or,

c. A prompt award will otherwise be advantageous to the Government.

If an award has been made at the time of the protest, the award will be overturned only for compelling cause (such as patent illegality or abuse), and then normally only upon the advice of the Comptroller General [Ref. 2]. The Comptroller General has four choices:

a. He may declare the contract illegal and void.

b. He may direct a termination for the convenience of the Government and award to the proper bidder.

c. He may write a letter of criticism to the agency.

d. He may send a letter to the protestor telling him that the agency's award was properly made.

Choices c and d are most often used by GAO.

Current interpretations on jurisdiction are being made on almost a daily basis. It is incumbent on the reader to review all current information as to the present status of forums available to a protester.

6. References


1. Department of the Army, Procurement Law, Pamphlet No. 27-153, January 1976.

2. Federal Acquisition Institute, Principles of Government Contract Law, Washington, D.C., September 1979.

3. "Number of Bid Protests Received abd Closed by GAO Sets New Record," Federal Contracts Report, Vol. 39, No. 1, 3 January 1983.

4. Office of the General Counsel, Government Contract Principles, Washington, D.C., November, 1980

5. Decisions and Rulings in Brief, "Bid Protests-Interested Parties-Specification," Federal Contracts Report, Vol. 39, No. 3, 17 June, 1983.

6. Feidelman, Joel F. and Ursini, Josephine L., "Federal Circuit Limits Jurisdiction Over Bid Protests", Legal Times April 18, 1983.

## B. TERMINATION FOR CONVENIENCE

### 1. Discussion

The Government has a right to discontinue the contract for reasons other than the default of the contractor. It can be in the best interest of the Government to refuse to continue with contract performance and to settle with the contractor at the point of termination as set forth in the termination for Convenience clause of the contract.

The Termination for Convenience of the Government clause is one of the most unique provisions contained in Government contracts. The clause gives the Government the right to terminate without cause and limits the contractor's recovery to costs incurred, profit on work done and the costs of preparing the termination settlement proposal [Ref. 1]. Recovery of anticipated profit is precluded. In no other area of contract law has one party been given such complete authority to escape from contractual obligations.

### 2. Right to Terminate

The language giving the Government the right to terminate is brief and very broad. For example, the termination clause contained in FPR 1-8.701 states:

> (a) The performance of work under this contract may be terminated by the Government in accordance with this clause in whole, or from time to time in part, whenever the Contracting Officer shall determine that such termination is in the best interest of the Government. Any such termination shall be effected by delivery to the Contractor of a Notice of Termination specifying the extent to which performance of work under the contract is terminated, and the date upon which such termination becomes effective.

Under this clause the Government has virtually unlimited authority to terminate for convenience, however, FPR

1-8.201(a) cautions contracting officers to use the clause only when it is determined that such action is in the best interest of the Government.

The right of termination for convenience may yet bind the parties "by operation of law," even if the required clause is omitted. In the landmark case of "G.L. Christian and Associates v. United States", 312 F 2d 418, the court held: (1) ASPR (now DAR) governed the contract, (2) ASPR was promulgated pursuant to law, (3) ASPR therefore has the force and effect of law, (4) ASPR required the clause, and (5) no authorized deviation was granted. The court therefore concluded that the clause is operative as though physically incorporated in the contract. The import of this decision extends to any required DAR clause. It is not to be assumed, however, that such clauses need no longer be incorporated into the contract. Government policy and good business practice dictate otherwise. The case nevertheless definitely extends termination for convenience coverage. [Ref. 2]

3. The Decision to Terminate

The decision to terminate contracts is made by the contracting officer with appropriate authority; however, cognizant technical and engineering personnel often are first to recognize the need for termination. These personnel continuously review outstanding contracts to insure that a requirement for the supplies or services involved still exists. If not, a termination for convenience action may be necessary. Postponing this consideration can cause needless expense to the Government.

As a rule, a termination request or similarly entitled document submitted by cognizant technical or engineering personnel, can provide the authority for termination action by the contracting officer. Termination is

actually accomplished when notice of termination is delivered to the contractor [Ref. 3].

4. Factors to Consider

There are a number of factors which the contracting officer must consider before effecting a termination. Some of these are [Ref. 4]:

a. Technological Advances. National security interest often dictate the placing of production contracts for interim items - an action that may be necessary even though more advanced items are under development. If and when the new items are released for production, contracts for the older items may have to be terminated in whole or in part.

b. Budgetary Considerations. Budgeting or funding factors may dictate termination if a new requirement with a higher priority develops. If funds are not available to continue both contracts then one would have to be terminated in whole or in part.

c. Effect on Subsidiary or Related Procurements. Like most other contractual actions, a termination has an impact that extens far beyond the present procurement. Therefore, when termination of an item is contemplated, the effect on related procurements must be evaluated. The termination of a contract for a major item usually results in widespread terminations of contracts for support material.

d. Requirements of other activities. Sometimes one military department may have a current or contemplated requirement for an item that another

military department would otherwise terminate. This possibility should be investigated before termination.

e. Estimated Cost of Termination. The estimated cost of the termination settlement often affects the decision to terminate. For one thing, the cost of settlement will determine the amount of funds to be available for other work after deobligation. Costs become especially important when the contract nears completion, allowing the contractor to complete the work may be preferable to termination even though the Government's requirements have changed or no longer exist. Of course, if the Government has no further use for the item, the contract is terminated if any savings are possible.

5. Implementation of Termination

DAR 8-801 provides approved forms of notice of termination. As a rule, notice is given first by telegraph and later confirmed by letter. However, notice by letter alone may be used. In any case, the notice should clearly state the following information: (1) the effective date of the termination, (2) the extent of work stoppage (total or partial), and (3) the specific work to be terminated, if the termination is partial. The notice may also include special instructions about the continuation of certain work, disposition of inventory, or other matters. In addition, the notice must contain recommended actions to minimize the impact on the contractor's personnel if a significant reduction of the work force is likely to result.

The notice of termination and the terms of the Termination Clause define the contractor's obligations upon termination. As soon as the contractor receives the notice,

he must stop work under the contract as directed, continuing unauthorized work only at his own risk and on his own account [Ref. 4]. The contractor is also obligated (1) to terminate all unperformed or partially performed subcontracts and purchase orders relating to the terminated portion of the prime contract and (2) to settle, with the approval of the contracting officer, all outstanding liabilities and claims arising from such terminations.

The duties of the Contracting Officer after issuance of the termination notice are listed in DAR 8-206. Among other duties, the contracting officer arranges a meeting with the contractor to develop a definite plan for effecting the termination settlement.

6. Settlement of Termination

The Government is under a legal obligation to make a fair and prompt settlement with the contractor after a convenience termination. Generally speaking, settlement of terminated contracts takes the form of negotiated agreements between the parties or unilateral determinations by the contracting officer. When the contractor and the contracting officer cannot agree to the terms of the settlement, a formula settlement may be utilized which is subject to appeal by the contractor, to the Armed Service Board of Contract Appeals. However, when the amount of the termination settlement involves $50,000.00 or more, whether negotiated or not, FPR 1-8.211-2(a) requires that the settlement be approved by a settlement review board before a settlement agreement is executed.

7. References

1. Cibinic, John, Jr. and Nash, Ralph C., Jr., Administration of Government Contracts, Government Contracts Program, George Washington University, 1981.

2. Federal Acquisition Institute. Principles of Government Contract Law, Washington, D.C.: U.S. Government Printing Office, September 1979.

3. United States Air Force Institute of Technology. Government Contract Law, Maxwell, AFB, Alabama, July, 1975.

4. United States Air Force Institute of Technology. Contract Administration, Vol II, Chapter 19, Maxwell, AFB, Alabama, 1980.

## C. TERMINATION FOR DEFAULT

### 1. Discussion

Under common law, when one party fails to discharge his duties under a contract, the other party may exercise a remedy of recovering damages for breach of contract. A common definition of breach is "a nonperformance of any contractual duty of immediate performance" [Ref. 1]. When the contractor has failed to perform and there is no excusable cause for the non-performance, the Government may terminate the contract for default. Default termination is the most extreme method of dealing with a contractor's actual or anticipatory failure to perform on time. Actual breach is a currently existing failure to perform the terms of the contract. Anticipatory breach is a prospective failure to perform the terms of the contract which is manifested by either some expression or conduct of one of the parties to the contract prior to the time set for the performance [Ref. 2].

The impact of a default termination is severe and has the following effects on the relationship of the parties [Ref. 3]:

a. the Government is not liable for the costs of unaccepted work and the contractor is entitled only to receive payment for work accepted by the Government;

b. the Government is entitled to the return of progress, partial or advance payments;

c. the Government has the right but not the duty to appropriate the contractor's material, inventory, construction plant and equipment at the site, and, under supply contracts, his drawings and plans -- the price for the appropriated items to be negotiated.

d. the contractor is liable for excess costs of

reprocurement or completion; and

e. the contractor is liable for actual or liquidated damages.

A default termination may also have adverse effects on the award of other Government contracts where past performance is considered in determining responsibility.

2. Decision to Terminate

A default termination is a contractual right of the Government to be exercised when the contractor has failed to perform his obligations under the contract. It is important to note, however, that the default clauses are permissive in that the Government may terminate but is not necessarily required to do so. This affords the Government the opportunity to view its contracts from a total concept of what is best in its overall interest. In one important case the Court of Claims has held that the contracting officer must affirmatively elect the default alternative or the default is invalid. [Ref. 1].

3. Fixed-Price Supply Contracts

The DAR default clause for fixed-price supply contracts (DAR 7-103.11) provides that the Government may terminate a contract for default, in whole or part, if the contractor fails to meet the following obligations: to deliver at the times required, to perform any other provisions of the contract, or to make the necessary progress in performance. Before termination for default, the contracting officer generally gives the contractor at least ten days' notice, stating the failure involved. The Government may then terminate for default by means of a second notice from the contracting officer if the contractor does not correct his faulure within a period of grace. However, the general rule is that a contractor already in

default is not entitled to any prior notice, unless there is a contract provision requiring such notice, and the contract may be terminated immediately.

The default clause also states reasons that will excuse a contractor's failure in performance. He is excused if the failure to perform arises out of: (1) acts of God, (2) acts of the public enemy, (3) acts of Government (either sovereign or contractual), (4) fires, (5) floods, (6) epidemics, (7) quarantine restrictions, (8) strikes, (9) freight embargoes, and (10) unusually severe weather. This list is not exhaustive, nor is it to be applied automatically. Only those causes beyond the control of the contractor, and not a result of his fault or negligence, will excuse him from liability [Ref. 4]. When a contract is terminated for default, and it is later found that the contractor's failure was excusable or that he was not, in fact, in default, the notice of default can be treated as a notice of termination for convenience and the rights and obligations of the parties to be governed by the applicable principles.

4. Cost-reimbursement Contracts

Cost-reimbursement type contract default termination provisions (DAR 7-203.10) permit the Government to terminate the contract in whole or in part, for actual default or failure to make progress such as would endanger performance and result in default. The financial results of a default termination are not substantial. The contractor will be reimbursed for all allowable costs, whether or not the work is accepted by the Government, and will even receive a portion of the fee provided for by the contract measured by the percentage of the work accepted by the Government [Ref. 3].

5. Procedure in Lieu of Termination

DAR 8-602.4 provides several courses of action in lieu of termination for default when it is determined to be in the best interest of the Government. They are:

a. Permit the contractor, his surety, or guarantor to continue performance under a revised delivery schedule.

b. Permit the contractor to continue performance by means of subcontract, or other acceptable third party.

c. If the requirement for the supplies or services no longer exists and the contractor is not liable to the Government for damages, execute a no-cost termination settlement agreement.

The provision permitting the contractor to continue performance under an extended delivery schedule generally must be accompanied by some consideration, monetary or otherwise, flowing from the contractor to the Government. This requirement arises out of the general rule that a Government agent, such as a contracting officer, is without authority to waive a vested right of the Government without receiving consideration. The right of the Government to require performance, within the period provided in the contract, constitutes such a vested right. [Ref. 1]

6. References

1. United States Air Force Institute of Technology, Government Contract Law, Wright-Patterson AFB, Ohio, 1979.

2. Federal Acquisition Institute. Principles of Government

Contract Law, Washington, D.C.: U.S. Government Printing Office, September 1979.

3. Cibinic, John, Jr. and Nash, Ralph C., Jr. Administration of Government Contracts, Government Contracts Program, George Washington University, 1981.

4. United States Air Force Institute of Technology. Contract Administration, Vol II, Chapter 19, Maxwell, AFB, Alabama, 1980.

7. Bibliography

Federal Acquisition Regulation (FAR), Planning Document, 31 December 1982.

# IV. FINANCIAL, ECONOMIC AND ACCOUNTING SUBJECTS

## A. PRICE ANALYSIS

### 1. Discussion

For every Government purchase transaction some form of price or cost analysis is required. Generally speaking, cost analysis (to be discussed as a seperate topic) is used when negotiating a large purchase, and price analysis is used in connection with competitive- bid purchasing [Ref. 1]. The method and scope of analysis required depend on the dollar value and other circumstances surrounding the specific purchase. Each agency of the Federal Government properly expects its contracting officer to negotiate and buy at the most favorable price levels obtainable and will judge the efficiency of its purchasing department on the prices paid. The contracting officer, however, considers price as only one of the conditions and terms of a purchase order, and will generally treat it equal to the other conditions and terms [Ref. 2]. The price must also be considered by the contracting officer to be fair and reasonable. The contracting officers decision that the price is fair and reasonable is based on some form of analysis, either price analysis or a combination of price analysis and cost analysis. Price analysis is the process which the contracting officer takes to reach a decision as to the fairness and reasonableness of a product or service without evaluating the separate elements of cost and profit required to provide that product or service. Price analysis may be done by comparison of prices or by comparison with engineering estimates.

Price analysis is performed for every Government procurement regardless of dollar value. If price analysis is alone is not sufficient to establish that a price is fair and reasonable, it may be used in conjunction with cost analysis. Price analysis includes:

a. Testing for Competition,
b. Compairson with Catalog or Market Prices,
c. Comparison with Past Prices,
d. Government Estimates,
e. Value Analysis, and,
f. Visual Analysis.

Each of these areas will be treated as separate sections below.

2. Testing for Competition

Four conditions must be satisfied before effective price competition can exist:

a. There must be at least two offerors. However, the number of quotations required for adequate price competition depends on several factors: (1) number of potential responsible offerors, (2) availability of product or service in general, (3) urgency of the purchase, and (4) dollar value of the purchase.

b. They must be capable of satisfying the Government's requirement. The companies should have the capacity, know-how and financing to complete the contract sucessfully.

c. They must be contending independently for a contract award. Even if there are two offers, one from the vendor and the other from the prime, and the vendor is the source on both offers, there may

be but one responsible offerer and therefore no price competition.

d. They must submit priced offers responsive to the expressed requirements of the solicitation. The responsiveness of the proposals to the terms of the request for proposals should be compared in terms of technical specifications, delivery schedules, quantity and other discounts, etc.

If these four condition have been met, price competition exists unless:

a. The solicitation was made under conditions that unreasonably deny some potential offerors an opportunity to compete, such as: insufficient time for submitting offers, short delivery time, or use of brand names for products or trade names for processes.

b. The low offeror has a definite advantage over the other offerors, such as one supplier being the only source of a component essential to satisfying the requirement.

c. It can be demonstrated that the lowest price negotiated is not reasonable and everything possible was done to negotiate a reasonable price.

If all four conditions of price competion are met and none of the above three factors apply, then price competition is judged to be effective.

3. Comparison with Catalog or Market Prices.

The DAR and FPR exempt established catalog or market prices from price analysis if four conditions are met. It must be evaluated on a case-by-case basis, to determine if

the price is, or is based on an established catalog or market price, for commercial items, sold in substantial quantities, to the general public.

a. Established catalog price.

A catalog price is included in a catalog, price list, schedule, or other form regularly maintained by the manufacturer or vendor; is either published or otherwise made available for inspection by customers; and states prices at which sales are being or were last made to a significant number of buyers who constitute the general public.

b. Established market price.

A market price is one currently established in the usual and ordinary course of trade between buyers and sellers free to bargain. It must be established from sources independent of the manufacturer or vendor.

c. Commercial item.

A commercial item is one of a class or kind regularly used for other than Government purposes and sold or traded in the course of normal operations.

d. Substantial quantities.

Supplies are sold in substantial quantities when the facts or circumstances support a reasonable conclusion that the quantities regularly sold are sufficient to constitute a real commercial market for the item. This test is usually in terms of total quantities sold, but it also should include the number of times the item has been sold, and how many times a given price or price structure has

been accepted by buyers free to choose. Services sold in substantial quantities are those customarily provided by the company, with personnel regularly employed, and with equipment, if any is needed, regularly maintained either solely or principally to provide such services.

e. General public.

An item is sold to the general public if it is sold to other than affiliates of the seller for end use by other than the Government. Items sold to affiliates of the seller and sales for end use by the Government are not sales to the general public.

Determining whether any one or more of several conditions apply will give a basis for deciding whether the price is reasonable. Chapter 8A of ASPM No. 1 deals specifically with the special requirements of determining whether a given item qualifies for exemption.

4. Comparison with Past Prices.

This method requires access to price history records on a line item basis. If a past price is being used for comparison, the past price must be proven to have been fair and reasonable and a valid standard against which to measure the offered price. It should be determined if the reasonableness of one of the previous prices was established by competition, detailed cost analysis, an engineering estimate, or market or catalog price. If not, it may not be appropriate to apply this method of price analysis.

Once satisfied that a previous price was reasonable, the next step is to compare it with the current price. Price comparison techniques are the same, regardless of

whether the standard is a past price, a purchase request estimate, or an independent estimate. Factors that might affect the comparison include: differences in specifications, quantities, and delivery schedules; inflation; government-furnished materials; and technological advances.

5. Government Estimates.

The techniques for comparing a price with a Government estimate are the same as for comparing with past prices. However, the basis for the estimate and its reliability must be established. If a product is susceptible to a realistic engineering estimate and that estimate has been carefully developed after a study of drawings, physical inspection, and reasonable projection, it may well be a reasonable standard and the price analysis is complete.

6. Value analysis.

Value analysis is the systematic and objective evaluation of a product's function and its related costs. When used as a price analysis technique, its purpose is to see if costs can be reduced. Value analysis can be a relatively expensive and demanding technique that may include analysis of the product's function, present and future anticipated operating costs, alternative approaches to the problem and their anticipated costs, each in relation to offered price. For low potential items, a brief survey can usually provide adequate value analysis. Questions to ask in such a survey are:

a. Can the product, or any part of it, be eliminated?
b. Can a standard part replace a special one?
c. Can a lower-cost product, material, or method be used?
d. Are paperwork requirements excessive or unreasonable?
e. Can parts be packaged more economically?

To do a good job the buyer must know what is being bought and what it does. It always helps to know what it looks like, how big it is and any other properties that can help the buyer grasp the probable costs of producing or otherwise acquiring it.

7. Visual Analysis.

Visual analysis means that a buyer can get familiar with an object by looking at one, or a picture of one, and by talking to someone who knows how it's used. Based on this knowledge, a buyer may be able to estimate a dollar value. Visual analysis is similiar to value analysis in that both are concerned with the answers to questions about obvious, external features. Visual analysis rarely is sufficient by itself and should be used to verify tentative conclusions reached after price comparison.

8. Other Guidelines

If the foregoing price analysis techniques are used and the contracting officer is still not satisfied that the price is reasonable, the next step is governed by the value of the purchase.

For those purchases less than $10,000, a review of the cumulative results of the above techniques is checked for reasonableness. If still not satisfied, the contracting officer can use an alternative method of arriving at a price negotiation. To negotiate means to bargain, to bring about by discussion and settlement of terms. In almost all cases it starts with a competitive bid, a firm bid in respect to the conditions and requirements as known at the time. [Ref. 1] The objective in negotiation is to find some basis for agreement. In following up on information developed in earlier steps in analysis, the contracting officer should be able to find this basis and find the offer, or an adjustment

of the offer, reasonable. If not, then the requisitioner should be notified and be requested to verify that the need still exists. If it does, a final decision on the fairness and reasonableness of the price, based on the analysis and common sense must be made and documented. The small dollar value does not justify the use of cost analysis techniques.

For purchases between $10,000 and $100,000, the contracting officer may request cost or pricing data. The techniques of cost analysis are applied as explained in the next topic. The contracting officer may accept the price as reasonable as a result of the cost analysis, in which case the work is complete, but negotiations with the offeror may be required before a final decision is made.

9. References.

1. Lee, Lamar, Jr. and Dobler, Donald W., Purchasing and Materials Management: Text and Cases, McGraw-Hill, Inc., 1977.

2. Heinritz, Stuart F. and Farrell, Paul V., Purchasing: Principles and Applications, Prentice-Hall, Inc. Englewood Cliffs, N.Y., 1981.

10. Bibliography for Further Study

Government Contracts Reports, ASPM NO. 1, Armed Services Procurement Regulation Manual for Contract Pricing, Commerce Clearing House, Inc., 15 September 1975.

## E. COST ANALYSIS

### 1. Discussion

Cost analysis as defined in government acquisition is the element by element examination of the estimated or actual cost of contract performance. It is required on noncompetitive negotiated procurements of $100,000 or more but can be useful on proposals of lesser value. Cost analysis must be done to prepare to negotiate an agreement on a pricing arrangement with the company that has made a proposal in response to a request. Cost analysis involves analysis of design features, manufacturing processes, organization and manning, materials and estimating assumptions, and all the other cost factors that make up the total cost of an acquisition.

Cost analysis includes verification of cost data, evaluation of specific elements of cost and projection of these data. Cost analysis looks into such factors as:

a. Necessity for certain costs.
b. Reasonableness of amounts estimated for necessary costs.
c. Extent of uncertainties involved in contract performance and realism of any allowances for contingencies.
d. Bases for allocation of overhead costs.
e. Appropriateness of allocations of particular overhead costs to the contract.

When the necessary data are available, a contractor or offeror's estimated costs may be compared with:

a. Actual costs he incurred previously.
b. His last prior estimate, or series of prior estimates, for the same or similiar item.
c. Current estimates from other offerors.

d. Prior estimates or historical costs of other companies for the same or similiar work.

Cost analysis also includes analysis of trends in costs. In periods of either rising or declining levels of cost, analysis of economic trends is essential. In periods of relative economic stability, and particularly in cases involving production of recently developed hardware, trends in direct material and labor cost must be analyzed.

2. Cost Estimates

The pricing proposal, also called the cost estimates, usually will be submitted on a preprinted form. The FPR form is the Optional Form 59 or 60, the DAR form is DD Form 633 and the NASA form is DD Form 633 (NASA Edition). It is sometimes assumed that the estimate must be a projection from the plateau of the most current experience. The "most current" would probably be a blend of recorded costs of producing items already on order and the estimated or actual prices from vendors and subcontractors for the contract effort being priced out.

3. Pricing Data

Pricing data is factual information about direct and indirect costs the contractor will incur in performing the contract. In accordance with Public Law 87-653 (Truth in Negotiations Act), the contracting officer must require the contractor to submit cost and pricing data along with its pricing proposal, and to certify that they are complete, accurate, and current at the time agreement is reached on price. The law provides for an adjustment in price if it is later found that the data were not complete, accurate and current and gives the Governmnet audit rights to ensure the data were as certified. These requirements apply to all

negotiated contracts and contract modifications expected to exceed $100,000 unless the price negotiated is based on adequate price competition, established catalog or market prices of commercial items sold in substantial quantities to the general public, or prices set by law or regulation.

The pricing data should show in detail the kinds, quantities, and prices of direct material and direct labor used to develop the summary figures shown in the proposal. The company should explain how it computes and applies indirect costs and should show trend and budgetary data.

4. Cost Elements

Four basic items are considered here in analyzing supplier cost proposals, these are: material cost, labor cost, overhead cost, and profit. Each of these cost elements are described as follows:

a. Material Cost.

Material cost can be broken down into the following two categories:

(1) Direct material. Direct materials include raw materials, purchased parts, and subcontracted items required to manufacture and assemble completed products. A direct material cost is the cost of material used in making a product and is directly associated with a change in the product. Because of this, direct material costs should vary in direct proportion to the number of items produced.

(2) Indirect material. Indirect materials are those not easily identified with an end product, usually are not significant in cost, and usually do not vary in direct proportion to

the number of items produced. Lubricants and coolants are examples of indirect materials common to a manufacturing operation.

b. Labor Cost.

The estimate submitted on the DD Form 633 may be a single figure, direct labor, or it may be two or more, depending on what is being purchased and how the contractor keeps his books. They could possibly be engineering labor, direct factory labor, and direct tooling labor as three possibilities. Direct labor costs are incurred as a direct result of producing an item. They vary in proportion to the number of items produced. There are two aspects of a direct labor estimate: the quantities of labor, and the rates that will be paid. Labor will most likely be separated into classifications such as factory labor and further into fabrication labor and assembly labor. For a very large contract, there might be further subdividing. The quantities may be the most recent times incurred in doing the same tasks. They may be straight line projections of actual hours. They may project a continuing reduction in required hours, or they may be engineered standards. The rates may be projected average rates by labor classification, by department, or by plant. The task in analyzing both quantities and rates is to find what was used, and whether the numbers are realistic in terms of the kinds and relative skills of labor needed to perform the contract. For example, an examination of engineering labor should include, in addition to type, quantity, and price of the engineers, a close look at why direct engineering

effort will be required for the particular contract.

c. Overhead Cost.

Overhead costs are indirect costs. An indirect cost is any cost not directly identified with a single final product, but rather with two or more final products. They represent supporting effort to the main business of the company that cannot be directly assigned to individual projects or contracts. The DD Form 633 provides four different groupings of indirect costs: material overhead; engineering overhead; manufacturing overhead; and general and administrative expenses. Footnote 10 of the DD Form 633 is cited in each of these groupings as follows:

> Indicate the rates used and provide an appropriate explanation. Where agreement has been reached with Government representatives on the use of forward pricing rates, describe the nature of the agreement. Provide the method of computation and application of your overhead expense, including cost breakdown and showing trends and budgetary data as necessary to provide a basis for evaluation of the reasonableness of proposed rates.

Each portion of this footnote, with examples, can be found in ASPM No. 1, Chapter 5a.

d. Profit.

There are several different approaches to analyzing and developing profit objectives. Some agencies use weighted guidelines to determine the profit objective. This is a systematic approach which offers a range of weights to be applied to elements of cost to determine dollar profit and provides for

adjustment of those dollars up or down for cost, facilities, investment risks, and other special factors. Other agencies use a less systematic approach. Therefore, the first step in analyzing profit is to find out what your contracting regulations prescribe. Most agencies are governed by FPR 1-3.808 and any implementing regulations they have promulgated. Profit policies also are set out in DAR 3-808 and NASA PR 3.808 which generally prescribe a profit objective that is fitted to a particular acquisition. Due weight is given to each of the effort risk, facilities, and special factors that may be involved.

5. Summary

After breaking the pricing proposal into separate elements of cost and analyzing each, the contracting officer has them assembled and looks at the total package. The next step is to negotiate the final price. It involves discussions, questions, and explanations for each cost element. When negotiation is over and both parties are satisfied, the contractor must certify that the cost or pricing data submitted and identified during the negotiation are current, complete, and accurate as of the date an agreement was reached. This is a requirement for all noncompetitive negotiated contracts over $100,000. Under $100,000, when a cost analysis is done and negotiations are held, a requirement for the same certification can be made, but it is not required. As a final step, the contracting officer must ensure that a written memorandum is placed into the official contract file that explains what the contractor proposed, what was found in analysis, what happened in negotiations and why the price agreed on was fair and reasonable.

## 6. Bibliography for Further Study

Government Contracts Reports, ASPM NO. 1, Armed Services Procurement Regulation Manual for Contract Pricing, Commerce Clearing House, Inc. Chicago, Illinois, 15 September 1975.

# V. PRODUCTION

## A. INDUSTRIAL MODERNIZATION INCENTIVES PROGRAM

### 1. Discussion

The Department of Defense Industrial Modernization Program (IMIP) is presently a test program whose primary purpose is to enhance the industrial base by motivating industry through contractual incentives to invest beyond efforts required to meet normal contractual obligation. Industry investments in modern plant and equipment are intended to improve production efficiency and productivity for defense work. The intent of the IMIP is to foster a successful business venture for both DOD and industry. It should reduce acquisition cost for DOD and improve the quality in weapon systems, equipment and material while industry should have improved profitability and increased business opportunities through modernization and productivity achievements. The IMIP encompasses and expands on the philosophy of the Military Services' "Technology Modernization" and "Industrial Productivity Improvement" programs, and implements DOD Acquisition Improvement Program Initiative No. 5, "Encourage Capital Investment to Enhance Productivity."

### 2. Background

In March 1982, a Tri-Service Committee for Improving Industrial Productivity was commissioned by the Under Secretary of Defense for Research and Engineering and chaired by Rear Admiral Sansone, Deputy Chief of Naval

Material for Contracts and Business Management. This committee was established to:

a. Draft a unified DOD policy on improving industrial productivity,

b. Define the contracting strategy and the use of financial resources necessary to implement the policy, and

c. Address the organizational, managerial, fiscal, legal, contractual and technical aspects of the policy.

The Tri-Service Committee developed a draft unified DOD policy and procedures in the form of a DOD Instruction (5000.XX) which defines the contracting strategy and the financial resources necessary to implement the program. On 2 November 1982, then Deputy Secretary of Defense (DEPSECDEF) Frank C. Carlucci authorized the Military Departments and the Defense Logistic Agency (DLA) to test the IMIP developed by the Tri-Service Committee. An executive level steering group composed of representatives for the DOD Components with OSD membership, and headed by Rear Admiral Sansone, was established by DEPSECDEF to monitor the conduct and to assess the results of the test program.

3. Policy

It is the policy of the Department of Defense that the IMIP should be applied:

a. To motivate industry investment beyond efforts required to meet normal contractual obligation.

b. To pursue the program to the maximum extent possible with contractors, subcontractors and vendors.

c. To encourage financing through the following incentives:

(1) Shared productivity savings reward;

(2) Contractor investment protection;

(3) Award fees;

(4) Multi-year contracts; and

(5) Direct government funding.

d. To focus on the long term goal of revitalizing and maintaining a capable defense industrial base as well as short term program, contract, and subcontract objectives.

4. Procedures

To achieve the objective of strengthening defense posture through improved manufacturing capability, procedures were developed in the areas of: early planning, type of approaches to utilize, contracting, and financing. Each of these areas are discussed below.

a. Planning. To achieve maximum effectiveness, IMIP should be considered early in the acquisition cycle for both major and non-major weapon systems, equipment and material. This does not, however, preclude implementing an IMIP later in the acquisition cycle.

b. Approach. IMIP will be tailored to the size, scope, and complexity of the project concerned. It will include an overall analysis of the manufacturing system of DOD prime contractors, subcontractors, and vendors for the project.

c. Contracting. IMIP contracting may cover a single

contract, a group of contracts, all contracts of a procuring activity, all contracts of a DOD component or all contracts of the entire DOD. A contract with prime contractors will have a flow-down to subcontractors or vendors; however, a subcontractor or vendor will be able to participate in an IMIP with multiple prime contractors or directly with DOD.

d. Financing. Contractors shall be encouraged to provide all funding for IMIP efforts. When it is in the best interest of the government, DOD funding may be provided. Also, contractor investment may be protected against termination/cancellation by a government contingent liability guarantee that may be shared within and among DOD components. This guarantee is for the IMIP expenditures made by the contractor for manufacturing technology, modernization and engineering/management applications.

5. Implementation

To test the IMIP concept DOD components will select a wide range of cases. The test program has been decentralized in order to allow each of the DOD Components to pursue incentives which they feel will best encourage productivity enhancing contractor capital investments. The results of the test will determine whether:

a. Contractors will increase their investment in capital assets,

b. Acquisition costs will be reduced, and whether

c. Subcontractors and vendors can be reached.

For the conduct of the test program the DOD Components have been authorized a blanket waiver to the Defense Acquisition Regulation (DAR) to encourage innovation

and chtain desired results. To implement the IMIP the follcwing DAR test clauses have been developed:

a. Government acquisition of assets. (This is a substitute clause for DAR 3-815)

b. A percentage share of savings clause.

c. A return on investment shared savings clause.

These DAR test clauses are not mandatory and can be tailored for use during the test program. Head of Contracting Activity approval will be obtained when specific deviaticns from DAR are required with the Steering Group being kept informed during the conduct of the test in accordance with the IMIP charter authcrized by the DEPSECDEF.

6. Eibliography for Further Study

Chief cf Naval Material Notice 5000, Subject: Test cf the Industrial Modernization Incentives Prcgram (IMIP) and Draft DOD Instruction 5000.XX, "IMIP"; immediate implementation of," 28 February 1983.

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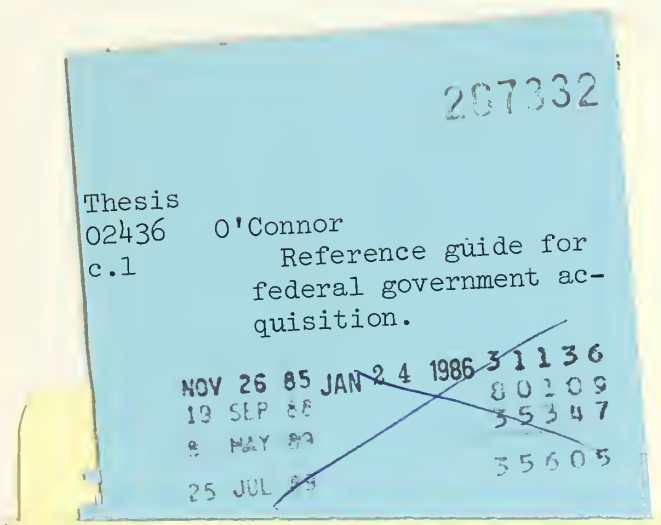
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